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In The

# Supreme Court of the United States

October Term, 1997

RUSSELL McLAUGHLIN, JR. and MARK McLAUGHLIN,

*Petitioners,*

*vs.*

UNITED STATES OF AMERICA,

*Respondent.*

*On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit*

## REPLY BRIEF FOR PETITIONERS

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## INTRODUCTION

Petitioners Russell McLaughlin, Jr. and Mark McLaughlin reply as follows to the brief for the United States of America in opposition to their Petition for Writ of Certiorari.

## DISCUSSION

### A. Tax Evasion Under 26 U.S.C. § 7201

The government contends that the petition for certiorari should be denied as to the issue dealing with the essential elements of tax evasion, relying upon two analytically separate grounds.

First, the government seeks to invoke certain prudential principles which suggest that a case which might be mooted by later events, or which might be brought up for review following resentencing, should not be reviewed at this stage. Using the label "interlocutory," the government notes that Russell McLaughlin, Jr. may indeed be found not guilty at retrial upon remand and Mark McLaughlin yet faces a resentence from which he may perfect a direct appeal.

These prudential considerations are certainly recognized in this Court's practice. However, they must give way to the very practical problem that the decision of the court below causes a split in authority and a great deal of confusion as to how tax evasion must be charged and proven.

The existence of a split in the circuits is discussed below. At this juncture, however, the point needs to be made that the third circuit decision, if indeed having ripened a split in authority, will likely cause the confusion which the government seeks to avoid. The question therefore is not whether this case

is sufficiently final so as to merit review; rather, the question is whether this Court should exercise its discretion to solve a split in the circuits and to eliminate uncertainty, and do so in an area of systemic importance. The question is answered, it is submitted, by determining whether the district courts in the third circuit are likely to hold that a pre-existing assessment is an essential element of evasion of payment under 26 U.S.C. § 7201. It is submitted that they will so interpret the decision in this case.

A related prudential principle which the government relies upon is the assertion that the petitioners will not benefit from a decision in their favor on the question of the elements of tax evasion. While this factor may be considered by the Court, there are subsidiary and related questions which flow from the fundamental decision — what elements are required for evasion of payment tax prosecutions — which by themselves will benefit these respondents. If this Court sets about the task of deciding whether evasion of payment requires a separate element of proof, it must also necessarily address the question of how such a change must be pleaded and proven. For example, if a separate element is required, must that element be set forth with specificity in an indictment? Does the use of the phrase "evade payment" function as a required signal to give notice to a defendant of the nature of the offense alleged?

The court below construed the language of Count II of the indictment to be broad enough to include an evasion of assessment theory. However, if it does include an evasion of assessment theory, its language is also sufficiently broad to include evasion of payment, charging that the petitioners did willfully attempt to "evade and defeat the payment of a large part of the income tax due and owing." App. G at 72a. If both offenses are within the same count, the count is rendered duplicitous. Accordingly, in its decision on the fundamental

issue of statutory interpretation, the Court will necessarily confront the issues of pleadings and specificity, both under the Federal Rules of Criminal Procedure and the Constitution, the resolution of which is likely to benefit the petitioners.

The government labels the process of determining what was charged as "fact-bound" in an effort to convince the Court not to grant review. It is submitted that the issue is not fact-bound in any meaningful sense, but rather depends upon a simple review of the language of but one count of the indictment, comprising about one-half of a page in the Appendix.

Second, and perhaps most important, is the government's contention that there is no split in the circuits on whether an indictment charging evasion of payment requires proof of a pre-existing assessment or other liquidation of the tax due and owing.

Nothing in the language of the third circuit's decision suggests that it *assumed* the requirement of such an element. Indeed, the opinion states that the tax evasion statute "includes two distinct offenses: evading assessment and evading payment." App. D. at 17a. The court further noted that "these offenses require different elements of proof" and cited the Seventh Circuit decision in *United States v. England,* 347 F.2d 425, 430 (7th Cir. 1965).

The government argues that the Seventh Circuit has itself overruled an interpretation of the *United States v. England* to the effect that a separate element is required for evasion of payment. *See United States v. Dack*, 747 F.2d 1172, 1174 (7th Cir. 1984); *United States v. Dunkel,* 900 F.2d 105, 107 (7th Cir. 1990). Nevertheless, even if these cases do narrow *United States v. England* in this regard, the Third Circuit has by citation to *United States v. England* adopted the broader interpretation advocated by the petitioners.

The fundamental question then, it is submitted, is how district courts in the Third Circuit are to interpret *United States v. McLaughlin*. The citation to *United States v. England* and the plain language of the opinion can only be read to require proof of a pre-existing assessment for evasion of payment prosecution. Indeed, the Third Circuit even cites its earlier decisions in *United States v. McGill*, 964 F.2d 222, 229 (3d Cir. 1992), for support of the statutory interpretation advocated by the petitioners.

Accordingly, it is submitted that there is a split in the circuits and that, assuming the validity of the government's statutory interpretation in this connection, there is much mischief to flow from that split and the confusion it necessarily will engender.

**B. Access to Accountants' Records Under 26 U.S.C. § 7602**

The government argues that there is no conflict between the decision in this case and the decisions of the courts of appeals in *Neece v. Internal Revenue Service of the United States*, 922 F.2d 573 (10th Cir. 1990) and *United States v. Kao*, 81 F.3d 114 (9th Cir. 1996). Cleaving to its position that informal receipt of records is authorized under 26 U.S.C. § 7602 without regard to the procedural requirements of 26 U.S.C. § 7609, the government labels the decision in *United States v. Kao* "irrelevant" to this case. Brief at page 12. Similarly, the government construes *Neece* as not holding "that section 7609 deprives the IRS of authority to obtain information about taxpayers through informal procedures."

Viewed from any reasonable prospective of the administration of the tax laws, *United States v. Kao* and *Neece v. Internal Revenue Service* plainly place substantial limitations on the very power asserted in this case, the power claimed under § 7602 to gain access or possession to records of banks, accountants and lawyers through informal means. While the

procedural situations in those cases differ from this case, those cases unequivocally and squarely reject the position advocated by the government in this case and the decision and analysis of the third circuit.

In *Neece*, a third-party record keeper (a bank officer) provided access to bank records to the Internal Revenue Service in an informal manner and without a summons. This kind of informal disclosure is precisely what was done by the petitioners' accountant in the record below.

The account holders in *Neece* sued for compensatory and punitive damages under the Right to Financial Privacy Act (12 U.S.C. §§ 3402-3422) ("RFPA") and named the Internal Revenue Service as a party defendant. Following the entry of summary judgment in the district court, the Tenth Circuit was confronted with the very claim raised by the government in the third circuit; that access to and the ability to receive the documents was authorized under § 7602. There, the government attempted to invoke an exception to RFPA which excluded from the procedural requirements of that statute access given to records in accordance with procedures authorized by Title 26. 12 U.S.C. § 3413(c). The "procedures" relied upon by the Internal Revenue Service in its effort to avoid the imposition of compensatory and punitive damages was the power under § 7602 to examine records.

This position was squarely rejected by the Tenth Circuit in *Neece* which based its decision on the same statutory analysis and policy arguments advanced by the petitioners in this case. The salient features of the record in *Neece* are found in this case: a private party which constituted a listed party under § 7609 provided documents to the IRS without the compulsion of a summons. In *Neece*, the Tenth Circuit reached the opposite conclusion to that reached by the Third Circuit, concluding

that the case should be reversed and remanded, subjecting the IRS to the possibility of compensatory and punitive damages for the same conduct relied upon by the petitioners in this case.

From the point of view of the administration of the tax laws, IRS agents in the Tenth Circuit are duty bound to seek and invoke the procedures under § 7609 should they seek or desire access to records of banks. In the Third Circuit, however, they may take custody of such records without following the procedures of § 7609 because of the decision in the court below. This conflict is as pointed as one can find and implicates substantial issues since it is found within the context of the administration of the tax laws.

*Kao* is far from "irrelevant" in the same manner. In *Kao*, the government did not follow the notification and procedures of § 7609 in an effort to gain access to bank records. Once again, it attempted to invoke its general powers to inspect under § 7602 seeking a court order authorizing and requiring the execution of a directive for access to any and all bank records. Once again, the broad interpretation of § 7602 — that it is not subject to or modified by the procedural requirements of § 7609 — was rejected. Relying on the same statutory and policy interpretations and arguments advanced by the petitioners in this case, the ninth circuit concluded that the procedures of § 7609 were mandatory.

The government attempts to distinguish *Kao*, it seems, on the grounds that a summons was used by the IRS in an effort to compel the tax payers to execute the directive. However, in *Kao*, no summons or other compulsive power would have been directed to the banks in question. Thus, *Kao* is simply another case where the IRS contemplated using informal means under § 7602 to gain access to the records from the third-party record holders, the banks.

There is a split between the Third and the Ninth Circuits in this regard: in the Third Circuit, there appears to be no limitation within the Internal Revenue Service Code should the government desire custody of records held by third parties, including accountants, lawyers, bankers and stockbrokers. In the Ninth Circuit, the government is required to resort to the procedures of § 7609 to gain access to those records.

It is therefore submitted that a conflict does exist between the circuits, one of which is the decision in the court below, and that, regardless of the variations in the precise procedural postures of those cases, the conflict is very real and palpable in the setting of the enforcement of the tax laws on a day-to-day basis.

Finally, the government seeks to invoke the principle that the Court should defer to agency expertise in the face of duly promulgated and codified regulations. Here, the government points to 26 C.F.R. § 301.7609.1(a) and asks this Court to afford the regulations "customary deference." However, the regulations only address the right to inspect records, not the power to take custody of them.

## CONCLUSION

The petitioners respectfully request that the Court grant the petition for writ of certiorari.

Respectfully submitted,

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